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C O N F I D E N T I A L SECTION 01 OF 02 ANKARA 000725

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TAGS: AJ ENRG EPET TU

SUBJECT: BP VALIDATES TURKEY,S DEMAND FOR LARGE GAS QUANTITIES FROM SHAH DENIZ II

REF: A. ANKARA 687

1B. ANKARA 490

Classified By: Economic Counselor Dale Eppler for reasons 1.4 (B) and (D)

11. (C) Summary. BP Natural Gas Manager Oktay Sen shared with us his view that the GOT,s play for large volumes of gas from Shah Deniz Phase II development is based on realistic projections of Turkey's future gas needs. Turkish industrial consumers and households will continue to convert to natural gas and to drive high demand for natural gas, even if an economic slowdown hits. BP believes Turkey is a large, credible market for Shah Deniz Phase II gas but wants to diversify its buyers by selling gas to Europe too. According to Sen, TGI is the furthest along and the most likely European pipeline project for Shah Deniz Phase II gas. Sen expressed concern that price negotiations for Shah Deniz Phase I gas, which he believes will be linked to gas prices for Phase II development, could go to arbitration and thus delay the development of upstream gas in Azerbaijan. End summary.

Turkey,s Gas Demand Projections Validated

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12. (C) At an April 3 meeting with Shah Deniz consortium partners, the GOT presented its gas consumption forecast that Turkey will have a gas deficit of 12 bcm by 2012 (reftel A). Those projections are based on gas demand growth in both industrial and residential sectors. On the industrial side, only 70% of Turkish industrial companies have access to the BOTAS (state-owned pipeline company) network of gas pipelines, which means the other 30% are using coal, diesel or other fuels. According to BP, gas is cheaper than all alternatives in Turkey,s domestic energy market, which means the remaining industrial consumers will want to convert to gas (and thus increase gas consumption Turkey) when the grid connections are ready. We challenged BP that a projected economic slow down could cool gas demand. They countered that without a change in the price fundamentals, gas will be preferred to other fuels regardless of the growth rates. On the residential side, the GOT,s projections are based on expanding the local gas distribution network from 89% of households to 100%. In addition, the GOT projects an expanding Turkish population. These two factors taken together add 15 million more people demanding residential gas

by 2020, which will require an additional 20-22 additional bcm.

#### Striking a Balance: Turkish and European Markets

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¶3. (C) Turkey is buying 75% of Shah Deniz Phase I volumes (6.6 bcm). Sen speculated that 11 bcm from Shah Deniz Phase II would be available for export from the Georgian-Turkish border. He calculated that 8-9 bcm of Turkish consumption from SD II would mean the consortium again would be selling 70-80% of its gas supply to Turkey. BP would prefer a more diverse portfolio of customers, and a balance between selling gas to Turkey and to Europe, though he did not know what the right balance might be. Originally, BP thought Turkish gas demand might be 1-5 bcm but, given his new understanding of Turkey's gas demand situation, BP would revise these figures up. Sen was cautious not to favor one particular gas pipeline route to Europe, but indicated that TGI was the furthest along and therefore the most likely candidate to get SD II gas.

#### Phase I Prices Will Determine Phase II Prices

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¶4. (C) BP suspects that the Turks will continue to link Shah Deniz Phase I and Phase II negotiations. Due to contract stipulations, Shah Deniz Phase I price negotiations will likely take six months to conclude starting from April 15, 2008 (the date when BOTAS officially agreed to enter price renegotiations with the Shah Deniz consortium). Sen said he thought the price reached for Phase I will also apply to Phase II. Despite Turkey's need for gas, Sen said Turkey's

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willingness to buy gas will likely depend on price, meaning a higher price would result in lower gas sales. He cautioned that Phase I negotiations could go to arbitration (reftel B), which would significantly delay resolution of the pricing issue and, as a consequence, delay upstream investment needed for Phase II. Sen said BP would like to make a decision to sanction the pipeline by the first quarter of 2009. In order to do that, they need to know more about Turkey's plans for gas transit tariffs and off-take requirements.

¶5. (C) Comment: Shah Deniz consortium members do not speak with one voice. For example, StatOil and BP have given different figures for SD II available gas exports and different project sanction dates. Each may have its own plans and designs to woo SOCAR, who appears to hold all the cards for SD II development. We should keep this dynamic in mind when speaking to company representatives. End comment.

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